

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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PLR-129422-11

Date:

October 18, 2011

LEGEND

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Trust 1 =

Trust 2 =

Trust 3 =

A =

Dear _____ :

This responds to a letter dated July 11, 2011, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted, X was incorporated on Date 1 under the laws of State. Effective Date 2, X elected to be taxed as an S corporation. On Date 3, shares of X were transferred to Trust 1. The current income beneficiary of Trust 1 failed to make an election to treat the trust as Qualified Subchapter S Trust (QSST). As a result, X's S election terminated on Date 3. X represents that Trust 1 has at all times met the requirements of a QSST, within the meaning of § 1361(d)(3). On Date 4, additional shares of X were transferred to Trust 1.

Additionally, on Date 5, X intended to transfer shares to Trust 2, but these shares were actually transferred instead to Trust 3. The current income beneficiary of both Trust 2 and Trust 3 is A, who filed an election to treat Trust 2 as a Qualified Subchapter S Trust (QSST) on Date 6, but did not make an election to treat Trust 3 as a QSST. After Date 5, additional transfers of X stock were made to Trust 3, instead of Trust 2. All the income allocable to the X shares held by Trust 3 was reported by A consistent with the shares being held by a QSST. On Date 7, the shares of X transferred to Trust 3 were transferred to Trust 2.

X represents that its S corporation election termination was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Further, X represents that X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) of the Code that may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year. Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6))

who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i) and the beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) of that portion of the QSST which consists of S corporation stock to which an election under § 1361(d)(2) applies. Section 1361(d)(2) provides that a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 3 and that the termination was inadvertent within the meaning of § 1362(f). We further hold that during the period from Date 5 to Date 7, Trust 2 will be treated as a shareholder of X.

Under the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, unless X's corporation election is otherwise terminated under § 1363(d).

Within 120 days from the date of this letter, the current income beneficiary of Trust 1 must elect to treat Trust 1 as a QSST, effective Date 3, with the appropriate service center. A copy of this letter should be attached to the QSST election.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code, including whether X was otherwise a valid S corporation or whether Trust 1 and Trust 2 are otherwise valid QSSTs.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

David R. Haglund

David R. Haglund

Chief, Branch 1

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes

cc: